the SmallBiz Builder

your monthly newsletter

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# Capital Gains & Deferred Proceeds

We have discussed in prior issues of this SBB newsletter that often on a sale of shares, you may realize a capital gain, but not have receipt of the full proceeds at the time of sale.

Where the proceeds won't be receivable until after the year of sale, to alleviate having to pay tax on the full gain you may be entitled to claim a "capital gains reserve". This reserve is basically a deduction claimed in the tax return to reduce the full amount of the capital gain added to your income. A portion of the capital gain is added to income each year. The amount added is a function of the proceeds receivable per year and a minimum amount that ensures that the entire gain will be included in income over 5 years. If the shares meet special criteria, you can even spread the gain into income over 10 years.

Claiming the reserve is optional, but you cannot claim the reserve if you sell the shares to a corporation or partnership that is controlled by you immediately after the sale.

When you claim the reserve for a given year, you add the amount you claimed back into your capital gains income for the next year. However, you continue to claim the reserve if there are still uncollected proceeds from the sale. The effect is that over time (maximum 5 or 10 years) the gain is taken into income.

Given that the capital gains inclusion rate is proposed to increase from one half to two-thirds as of June 25th, 2024 (see our May SBB newsletter), you may want to think twice before claiming that capital gains reserve. We still don't have draft legislation to review for the proposed increase in the capital gains inclusion rate. However, if normal rules apply, it would be in the future years that you spread that capital gain into income, not the sale date, that will determine what inclusion rate applies.

There are other considerations. Consider who is selling the shares and how much gain would be included in the income with the reserve. If the seller is an individual, keep in mind that the Federal budget is proposing to keep the ½ inclusion rate if the capital gain is $250 000 or less per year. Corporations don't have this $250 000 threshold, and any capital gains they realize as of June 25th will be subject to the two-thirds inclusion rate. Of course, the reason behind claiming a capital gains reserve is because not all the proceeds have been received yet. There must be sufficient funds available to pay the taxes if the reserve isn't claimed.